Referee Report on

Impact of Monetary Policy Instruments on Islamic Stock Market Index Returns

Economics

Summary:

In this paper the author seeks to examine if the interest rates and interest rate volatilities have any impact on the Islamic and conventional stock indices returns and return volatilities respectively, in Malaysia and the United States. The author also aims to establish which of the various monetary policy variables have larger impact on the Islamic indices returns and their volatilities in these two countries and if investing in Islamic indices offer a good hedge against inflation.

The author closely follows the conceptual and methodological framework used by Yusof and Majid (2006, 2007) and employ GARCH framework on monthly data from April 1999 to December 2007. The author, however, uses an augmented set of monetary policy variables gleaned from other studies besides Yusof and Majid (2006, 2007)

The paper concludes that return and volatility of Islamic and non-Islamic indices in Malaysia and the USA are influenced by different set of variables.

Factors influencing the returns and volatilities of Islamic and non-Islamic indices within same countries have been studied before [e.g. Yusof and Majid (2006, 2007)]. The contribution of the paper lies in simultaneously studying the two types of indices in two different markets i.e. in Malaysia and the US. Islamic indices in Malaysia and the US use different screening criteria for stock inclusion, therefore, this study may add to our understanding on how cross country differences (e.g. different screening or eligibility criteria) may differentially influence the impact of monetary policy variables on the returns and volatilities of Islamic indices.

The idea of the paper is interesting. However, in my opinion this paper needs substantial revision in write-up before it can be published in Economics.

Major and concerns:

1. Write-up (errors and omissions):

The quality of write up is a major concern in this paper. Presence of too many errors and omissions is not only distracting but also makes it difficult to understand or to decipher incorrectness in argument from typographical error. The readability of this paper can be significantly improved by making appropriate corrections and paraphrasing where necessary.

2. Analysis:

At most occasions, the author only mechanically explains the results without giving an economic interpretation of the results. The author needs to explain the significance or importance of numerical results, that he obtains, and their implications.

Minor Issues:

1. Motivation of model:

   The author needs to better motivate if there is a need for GARCH terms, this can be done by reporting standard diagnostic tests.

2. Different screening criteria:

   The author mentions that there are different screening criteria for Islamic indices in Malaysia (KLSI) and in the US (DJIMI) and different screening criteria can (partially) explain differential response of index return and volatility to changes in monetary policy variables. However, the differences in screening criteria are not mentioned in the paper. The author should mention the difference in screening criteria for the two indices and should explain how these differences can affect the impact of monetary policy variables.

3. Non-Islamic indices investing in same stocks as Islamic indices:

   The author recognizes that non-Islamic indices may also be investing in the same securities in which Islamic indices invest. Non-Islamic indices would react to changes in interest rates, thereby, influencing the returns and volatilities of the underlying securities. Changes in interest rate would therefore, influence the return and volatilities of Islamic indices (investing in same securities) as well. The author should explain how this phenomenon affects his results.

4. Different notations in tables and text:

   For same parameter the author uses different notations in the text (model) and in the tables (e.g. model 2 and table 4.4). This creates unnecessary confusion and better be avoided.